



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Amended	3/23/00	Bill No:	AB 1901
Tax:	Property	Author:	Cedillo et al.
Board Position:		Related Bills:	AB 601 (1999)

BILL SUMMARY:

This bill would permit certain buildings converted to residential or live-work units to be valued according to a specified capitalization of income method.

ANALYSIS:

Current Law:

Under current law, there are no special provisions to assess commercial buildings located in economically depressed areas that are converted to residential use. Existing law does provide preferential assessment treatment for certain historical properties. Article XIII, Section 8 of the California Constitution provides that “[t]o promote the preservation of property of historical significance, the Legislature may define such property and shall provide that when it is enforceably restricted, in a manner specified by the Legislature, it shall be valued for property tax purposes only on a basis that is consistent with its restrictions and uses.”

Revenue and Taxation Code Section 402.1 provides that in the assessment of land, the assessor shall consider the effect upon value of any enforceable restrictions to which the use of the land may be subjected, including a restriction as a result of a recorded contract with a governmental agency.

Proposed Law:

This bill would authorize a new type of economic development area, called an urban adaptive reuse zone (UARZ). The boundaries of these zones would encompass areas with a high concentration of commercial buildings built before 1975 having an average vacancy rate exceeding 30 percent for at least six months. The Trade and Commerce Agency (TCA) would select up to 10 UARZs from applications submitted by local governing bodies. The designations would be binding for ten years with the possibility of a ten year extension if specified vacancy rates exist after the initial period.

Local legislative bodies would by ordinance designate individual buildings located within the UARZ as “qualified adaptive reuse buildings.” To qualify a building must have been built before 1975 and have been 50% or more vacant, excluding first floor retail space, for a period of six months or longer within the 12 months prior to applying to the TCA. Qualified adaptive reuse would include (1) conversion of a nonresidential

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building to include at least 25% of the floor area as residential units or 50% of the floor area as live-work units, or (2) a 50% increase in residential or live-work use of floor area of an existing residential or live-work building. The property owner would be required to sign an agreement to use the property for adaptive reuse housing for ten years. At the option of the property owner, the restriction agreement could be renewed for up to ten more years, if the adaptive reuse housing remains.

With respect to property taxes, this bill would amend Section 439.2 of the Revenue and Taxation Code to extend the special assessment provisions for valuing enforceably restricted historical properties to qualified adaptive reuse buildings located in urban adaptive reuse zones. When valuing a qualified adaptive reuse building, the property would be valued by the capitalization of annual income method set forth in Section 439.2, which is explicit in its instructions as to the estimation of the income to be capitalized and the rate used to capitalize the income. (Assessment procedures pursuant to Section 439.2 are more favorable than those provided for under Section 402.1).

In General:

Owners of certain historical or architecturally significant properties may benefit from limitations placed on the assessor's valuation. The property must be on the National Register of Historic Places or in a historic district. If not, the property can still qualify if it is listed on the official register of the state, a county, or a city as a historic or architecturally significant site, place, or landmark. The owner must enter into a contract with a city or county that provides for the preservation of the property for a specified period of time. The contract may also call for the owner to restore or rehabilitate the property in conformance with the rules and regulations of the Office of Historic Preservation of the Department of Parks and Recreation, with the contract binding on any successor to the owner.

Background:

This measure is essentially similar to AB 601 (Cedillo) of 1999. As passed as amended by both houses, however, to instead appropriate \$6 million for grants to building owners in Los Angeles and Compton for partial reimbursement of the costs to renovate their buildings for adaptive reuse, the governor vetoed the bill. The veto message noted, "[a]s California moves into the next century, revitalization of its numerous urban core areas is of vital importance to every community of this state. I fully support the intent of this bill; however, the funding source and limited scope of the bill is inappropriate. I would support a similar program to be included in the housing bond proposed for the November 2000 ballot and expansion of the program to allow participation by other California communities facing downtown revitalization challenges."

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COMMENTS:

1. **Sponsor and Purpose.** This bill is sponsored by Central City Association of Los Angeles in an effort to create an incentive program for the adaptive reuse of older, mostly vacant commercial buildings in those California cities where this activity is not yet market driven.
2. **This bill would extend the existing assessment procedures for enforceably restricted historical properties to qualifying commercial buildings built prior to 1975 that are planned to be converted to residential uses.** These properties would be assessed at the lowest of three values: (1) the value produced under the restricted income method, (2) the factored base year value pursuant to Proposition 13, or (3) the current fair market value pursuant to Proposition 8.
3. **Responsibility for determining whether a specific building located within a zone would qualify for these special assessment provisions would rest with the local agency entering into the agreement.** The owner of a building would be required to sign an agreement with the local governing agency to use the property for adaptive reuse housing for a period of ten years.
4. **The constitution provides that the special assessment provisions are to be extended to preserve properties of “historical significance” as defined by the Legislature.** While the constitution gives the Legislature the authority to define “historical”, it could be argued that extending these provisions to high-vacancy buildings that qualify solely because they are built prior to 1975 goes beyond the intent of this constitutional provision.
5. **Would these buildings be permanently assessed using this method?** The zones and restrictions are for a finite period of time. Presumably, the special assessment procedures would end after the property is no longer subject to the restriction agreement. A significant property tax increase could be likely at the end of the agreement.
6. **These buildings are primarily vacant.** The special assessment procedure set forth in Section 439.2 is based upon the income stream to the property. This restricted valuation method is intended to keep the assessment of the property in line with the actual income stream of the property which may not otherwise be maximized because the preservation of the property may not result in its highest and best use. Except for the first floor retail space, these buildings are already primarily vacant. Further, there would likely be a period of months to years before construction to convert the upper floors of the buildings to residential use was completed and rented to tenants. Thus, it is possible that the income stream used to value the property could be somewhat minimal. The local agency may want to stipulate a minimum annual income as provided in Section 439.2(a)(3) in determining the value of the property for property tax purposes.

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7. **Suggested Amendments.** As drafted, this bill appears to require the assessor to monitor whether the property is being used according to the terms and conditions of the agreement entered into by the property owner and the local governing body. That duty is more appropriately placed on the local agency who entered into the agreement. The following suggested amendment to Section 439.2 would clarify this point:

439.2 (g) If the owner of a property subject to an adaptive reuse restriction agreement, as described in Section 7093 of the Government Code, fails to operate the property in accordance with the terms and conditions of the agreement, the local legislative body that entered into the agreement shall notify the county assessor who shall reassess the property without regard to the methods provided in this section and shall add a penalty equal to 120 percent of the cumulative tax relief received under this section.

COST ESTIMATE:

The costs associated with this measure are absorbable.

REVENUE ESTIMATE:

Background, Methodology, and Assumptions

Any difference in property tax revenue would only result if the value of the property determined using the capitalization of income method is less than either the property's factored base year value pursuant to Proposition 13 or its current fair market value pursuant to Proposition 8. Generally, enforceably restricted historical properties are assessed using the capitalization of income method because it produces the lowest value under the three valuation methods. The Staff estimates that the assessed values of historical properties that currently qualify under existing law are 25 to 50 percent lower under the specified income capitalization method than they would be if assessed at their factored base year values.

The revenue effect of this proposal cannot be estimated due to the lack of data for many of the factors involved. These factors include:

- 1) The size and location of the Urban Adaptive Reuse Zones cannot be predicted.
- 2) Since counties do not report the distribution of their rolls by year of construction, we have no estimate of the percentage of commercial properties built before 1975.
- 3) Current and future vacancy rates cannot be determined.

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- 4) Since current and future rental rates are not available, the difference in assessed value using the capitalization of income method compared to the current assessed value cannot be determined.

Revenue Summary

Because this bill involves a number of unknown and unpredictable variables, in particular the size and scope of the zones and projects involved, it is not possible to determine the overall potential revenue decrease. However, it is likely that the assessed value of a qualifying property will be as much as 25 to 50 percent lower under this proposal. And, it is possible the potential growth of these projects could escalate into much larger revenue losses in future years.

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